



TATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
TELEPHONE (916) 445-5580
FAX (916) 323-3387

JOHAN KLEHS
First District, Hayward

DEAN F. ANDAL
Second District, Stockton

ERNEST J. DRONENBURG, JR.
Third District, San Diego

KATHLEEN CONNELL
Controller, Sacramento

JOHN CHIANG
Acting Member
Fourth District, Los Angeles

E. L. SORENSEN, JR.
Executive Director

May 27, 1997

Dear Mr. Clark:

This letter is in response to your phone discussions with Senior Tax Counsel Kristine Cazadd and me, and your written correspondence of April 25, 1997 concerning the applicability of exclusions from change in ownership to an irrevocable qualifying discretionary bypass trust. To briefly summarize the relevant facts: In 1989, your client (hereinafter "Wife") and her husband (hereinafter "Husband") established The Family Trust (hereinafter "Family Trust"), a revocable inter vivos trust, and the Children's Trust, a qualifying discretionary bypass trust which would become irrevocable upon the death of one of the settlors. Husband subsequently died and Children's Trust become irrevocable. The trust instrument designated the surviving settlor spouse and the two children of the settlors as beneficiaries of the Children's Trust and provided that they shall act as co-trustees of same. Under the terms of the instrument, the trustees may allocate or distribute income from the trust property within the defined group of beneficiaries in accordance with the sprinkling or spray provisions of the Internal Revenue Code. The trustees also have discretion to invade principal, if necessary, pursuant to guidelines set forth in the trust instrument.

Because the Children's Trust includes sprinkling provisions to a group of beneficiaries, you request a legal opinion as to whether the interspousal and parent-child exclusions would operate to exclude trust real property from change in ownership which occurred when the trust became irrevocable at Husband's death. As further explained below, it is our view that under the facts as presented, both the interspousal exclusion and parent-child exclusion would be applicable so long as the qualifying requirements of the interspousal exclusion and parent-child exclusion are met. Thus, when the Children's Trust became irrevocable the trust real property could be excluded from change in ownership.

LAW AND ANALYSIS

Revenue and Taxation Code section 60 defines "change in ownership" to mean "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." With regard to change in ownership of trust real property, Section 61 provides that "[e]xcept as otherwise provided in section 62, change in ownership as defined in section 60, includes, but is not limited to: . . . (h) Any interests in real property that vest in persons other than the trustor (or, pursuant to Section 63, his or her spouse) when a revocable trust becomes irrevocable." Section 62 provides in relevant part that "Change in ownership shall not include: . . . (d) Any transfer by the trustor, or by the trustor's spouse, or by both, into a trust for so long as (1) the transferor is the present beneficiary of the trust, . . .". Thus, under the change in ownership provisions, interests in the real property that vest in a trustor and the spouse of a trustor when the trust becomes irrevocable are clearly excluded from change in ownership.

In this instance, however, interests may vest in persons other than the trustor or the trustor's spouse when the trust becomes irrevocable such that subdivision (h) of section 61 would be applicable. In this regard, Rule 462.160, which interprets section 61(h), provides, in relevant part, that:

(b) A transfer to a trust is not a change in ownership upon the creation of or transfer to a trust if: . . .

(2) The transfer of real property or an ownership interest(s) in a legal entity by the trustor(s) to a trust which is revocable by the trustor(s); provided, however, a change in ownership does occur at the time the revocable trust becomes irrevocable unless the trustor-transferor remains or becomes the sole present beneficiary.

* * *

(4) The exemption afforded interspousal transfers is applicable; provided, however, a change in ownership of trust property does occur to the extent that persons other than the trustor-transferor's spouse are beneficiaries of the trust.

Thus, subdivisions (b)(2) and (b)(4) of Rule 462.160 would seem to preclude the exclusion from change in ownership of trust real property where persons other than the trustor-transferor or spouse are or become present beneficiaries.

Rule 462.160 has not been substantively amended since 1981 and at that time there was no exclusion from change in ownership for transfers between parents and children. In 1987 section 63.1 was enacted and provides, in part, that in the event of purchases or transfers between parents and children, change in ownership shall not include the purchase or transfer of a principal residence or the first one million dollars of real property for which a claim is filed. Furthermore, subdivision (c)(9) of section 63.1 expressly provides that such a parent-child transfer "includes, and is not limited to, any transfer of the present beneficial ownership of property from an eligible

transferor to an eligible transferee through the medium of an inter vivos or testamentary trust.” Therefore, within the limitations of section 63.1 and provided that the qualifying requirements are met, in our view, interests in the trust real property which vest in the two children as beneficiaries, as well as interests which vest in the trustor’s spouse, could be excluded from change in ownership.

Effect of a Sprinkle Provision

Where the trust instrument provides that trust beneficiaries have readily ascertainable interests and statutory exclusions from change in ownership are applicable, then those interests may be excluded from change in ownership. However, the beneficial interests are not ascertainable if the trustee has discretion to sprinkle income or invade principal for the benefit of any or all beneficiaries. If the beneficial interests cannot be ascertained, it necessarily follows that exclusions from change in ownership cannot be determined because the trustee may distribute to some beneficiaries and omit other beneficiaries. Therefore, in a trust which provides that the trustee may exercise a sprinkle power and where the group of beneficiaries include some persons to whom exclusions are available and some to whom no exclusions are available, then no exclusions are available.

In various legal opinion letters, Board staff has expressed the view that all exclusions must be denied in cases where a trustee has discretion to distribute among a group of beneficiaries and no exclusion is available for at least one of those beneficiaries. For example, in a 1981 letter, staff stated that if the trustee has discretion to distribute income among beneficiaries who included persons other than the spouse of the trustor then the interspousal exclusion would not be available. In such a situation the spouse would not be the sole present beneficiary as required by former Rule 462(i) (now renumbered as Rule 462.160). The views expressed in the letter reflected the fact that the only applicable exclusion available at that time was the interspousal exclusion.

Since the letter of 1981, as noted above, section 63.1 has been enacted to exclude transfers in trust between parents and children and, therefore, staff is now of the opinion that a transfer in trust should be excluded from change in ownership where the trustee has a sprinkle power among the trustor-transferor’s spouse and children as the sole present beneficiaries. The rationale is that if the group of beneficiaries includes only a spouse and children, there is no possibility that distributions of income or principal could be made to beneficiaries for whom the interspousal and parent-child exclusions are not available. Therefore, where the group of beneficiaries includes only persons for whom exclusions are available, then the applicable exclusions should be applied so as to exclude from change in ownership, to the extent that applicable exclusions permit, the transfer of real property to the trust. In this case, the beneficiaries of the Childrens’ Trust include only a settlor and the children of the settlors and clearly transfers to such persons are excluded from change in ownership. Thus, it is our view that the sprinkling provision would not bar application of the interspousal and parent-child exclusions to the transfer which was effected when the revocable trust became irrevocable.

For purposes of our analysis here, we have assumed that any real property which underwent change in ownership when the trust became irrevocable is within the one million dollar (\$1,000,000) full cash value limitation of section 63.1. If such is not the case, we may reconsider our analysis in light of the different facts.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

You may wish to consult the appropriate assessor in order to confirm that the described property would be assessed in a manner consistent with the conclusions stated above.

Very truly yours,

Lou Ambrose
Tax Counsel

LA:ba

cc: Honorable Dick Frank, San Luis Obispo County Assessor
Mr. James Speed, MIC:63
Mr. Dick Johnson, MIC:64
Ms. Jennifer Willis, MIC:70



STATE BOARD OF EQUALIZATION

1010 N STREET, SACRAMENTO, CALIFORNIA
P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
TELEPHONE (916) 323-7713
FAX (916) 323-3387

JOHAN KLEHS
First District, Hayward

DEAN F. ANDAL
Second District, Stockton

CLAUDE PARRISH
Third District, Torrance

JOHN CHIANG
Fourth District, Los Angeles

KATHLEEN CONNELL
Controller, Sacramento

E. L. SORENSEN, JR.
Executive Director

November 5, 1999

The Honorable Dick Frank
San Luis Obispo County Assessor
Attn: Ms. Barbara Edington, Transfer Supervisor
County Government Center, Room 100
San Luis Obispo, CA 93408-2070

RE: Change in Ownership Workshop, Level II Coursebook

Dear Barbara:

This is in response to your faxed request of September 24, 1999, and subsequent request faxed on 10/29/99, asking for our review and comments concerning the content of the proposed coursebook on trusts and partnerships (attached) for the Level II Change in Ownership Workshop of the California Assessor's Association. The following suggestions may be of some assistance in the development of the final coursebook. Please note that the suggestions made by Lou Ambrose of our staff are indicated by strikeout and underline in the 10/29/99 document, while the suggested changes to the proposed text of 9/24/99 document are described by this letter.

1. **Page 1: Trusts**

Add the following Section 62(d) principles to the introduction on trusts.

Although explained in the Level I Coursebook, proper application of these principles is required here in order to identify the "owner" in *any* type of trust.

"Trusts are used as an estate-planning tool and since the inception of Proposition 13, have been considered as substitutes for a will. Therefore, it is necessary to look through the trust to determine the present beneficial owners of the trust property. As a general rule, Section 62(d) is written to allow only one change in ownership for property transferred in trust. Subject to some exceptions, that change in ownership occurs either upon transfer into trust, or upon distribution to the beneficiaries. Whether the trust is revocable or irrevocable, the "owner" of the property in trust is always the trustor (transferor, sometimes called "settlor") if: 1) the trustor can revoke the trust, or 2) the trustor is the sole present beneficiary. (See Report of Task Force on Property Tax Administration to Assembly Revenue and Taxation Committee, January 22, 1979, p. 43-44.) The trustee is never viewed as the "owner" of the trust property for change in ownership purposes, even though he/she has "legal title" and the power to sell. (See Annotation No. 220.0761, Rules 462.160 and 462.240.) The beneficiaries become the "owners" of the trust property and a change in ownership occurs when: 1) the trustor of a revocable trust dies and the trust becomes irrevocable, or 2) the trust is irrevocable at the time of its creation and the beneficiaries receive present beneficial use of the property or present income from the property. (Allen v. Sutter County Board of Equalization, 139 Cal. App. 3d 887, (1983).)"

“The most common type of trusts is the standard revocable living (inter vivos) trust. Under Section 61(h), there is a change in ownership of the trust property when the trustor dies and the trust becomes irrevocable. If Husband and Wife are both trustors, and the children are named as beneficiaries, the following events occur on the death of the first trustor/spouse: 1) the trust estate is divided into two trusts, “A Trust” and “B Trust”;¹ 2) the assets of the deceased spouse (separate and community property) are distributed into “A Trust” and the assets of the surviving spouse are distributed to B Trust; 3) the surviving spouse is the sole present beneficiary of A Trust for her lifetime (holds the equivalent of “life estate”); 4) the surviving spouse is the fee owner of B Trust whether it is revocable or not; and 5) the children have only future interests in both A and B Trusts until the surviving spouse dies or if the surviving spouse transfers the trusts’ properties to them. (The transfer of all of the property in A Trust to the surviving spouse is excluded from change in ownership per Sections 62(d), and 63, and Rule 462.160(b)(1)(A) Examples 2-3.)”

2. **Page 1: Charitable Remainder Trusts**

Add the following information on “Charitable Remainder Trusts” to conform to Annotation Nos. 220.0810 (attached).

“Such trusts may be called charitable remainder annuity trusts, charitable remainder unitrusts, or charitable remainder net income trusts. To qualify as a ‘remainder trust,’ the income from the property transferred into the trust is reserved to the trustor (or trustor’s spouse or children) with the remainder interest in the property distributed to the charitable organization at the termination of the trust. The transfer of property to the trust is not a change in ownership if the trustor never takes any income but merely allows it to accumulate for future distribution to the charity.

“In contrast, a charitable lead annuity trust (‘CLAT’) is also irrevocable, but is structured quite differently. The charity is the sole present beneficiary entitled to receive all of the income from the CLAT property for a given number of years. At the termination of that income interest, the remainder beneficiaries (trustor’s family members) receive the property. The trustor retains absolutely no interest, except the right to report all the income payable to the charity each year on the grantor’s personal tax returns. (Cazadd letter 10/30/96, pgs. 19-20, attached.)”

3. **Page 1-2: Qualified Personal Residence Trusts**

Possible corrections should be made based on attached Annotation No. 625.0208 (Cazadd Letter 10/14/99 and Eisenlauer Letter 1/10/96). QPRT’s are generally limited to a 10 year term and the trustor retains beneficial ownership until the trust terminates and the property transfers to the beneficiaries.

4. **Page 2: Testamentary Trust**

Make the following revisions:

“A testamentary trust is any trust created within a will and executed under the formalities of a will. It is a trust which does not take effect and under which property does not transfer until the death of the settlor/trustor. The terms of the trust must be examined to determine who is to receive the trust property and in what shares as of the date of death.”

¹ The suggested description of an A-B Trust situation is currently published in Examples 2 and 3 of Rule 462.160(b)(1), and is important for properly applying the rule provisions.

5. **Page 2: Special Trust Terms**
Sprinkling Provisions

Example 1: Revise the first sentence as follows:

“ X dies and the terms of his testamentary trust have a sprinkle/spray provision empowering the trustee to distribute the trust income among X’s beneficiary group. The group consists of ...”

6. **Page 3: General vs. Special Power of Appointment**
Add to the following to end of the second paragraph:

“Under subdivision (b) and (c) of Probate Code Section 611, the power to invade the trust property or income is ‘special’ or ‘limited’ if: 1) it is for the benefit of some person whom the donee is obligated to support or is limited by an ascertainable standard (such as, “health, education, support or maintenance”), or 2) it is exercisable by the donee in conjunction with a person having an interest that is adverse to the donee.”

7. **Page 4: Example 1 and Discussion**
Delete entire Example 1 and Discussion; substitute the following:

“**Example 1:** Father (F) established a trust in which his beneficiary/child Daughter (D) was given a power of appointment over her share of F’s Trust property in the event that she died before the trust was terminated. Later, D specified in her trust that he right, title, and interest in F’s Trust would transfer her husband and children. D’s husband had been previously married and his children became D’s stepchildren. D died and her stepchildren filed a claim for the parent/child exclusion.”²

“**Discussion:** The exclusion applies for two reasons. First, the power of appointment was general, rather than special, in that D could exercise it on her own behalf and for her children, as if she owned the property. Since D exercised the power, she effectively transferred F’s Trust property directly from herself to her stepchildren. Secondly, D’s stepchildren qualify as her “children” under Section 63.1(c)(3)(B) since the stepparent – stepchild relationship is deemed to exist to the date of death, which is the date of the transfer. Note: if D’s husband died first, the stepparent – stepchild relationship is deemed to exist until D remarries.”

Add Example 2 as follows:

Example 2: (Annotation No. 625.0230, Eisenlauer Letter 4/6/92.)

“Husband and Wife create a testamentary “A/B” trust, each of which is funded with ½ of the community property and ½ of Wife’s separate property. Upon death of first spouse H, the surviving spouse W, is entitled to all the income from both trusts, with a general power of appointment of all the assets in one trust and an annual, non-cumulative right to receive the amount of \$5,000 or 5% of the aggregate value of the other trust. Since W as the surviving spouse, had a general power of appointment over both trusts, she is considered to be the owner of all property subject to the power. To the extent that the power is not exercised, when she dies, the transfer is treated as from the holder of the power, i.e., W. To the extent that she did not exercise her power each

² Example of patterned on Annotation No. 220.0771, Ochsner Letter 12/26/90.

year she had it, the lapse resulted in the beneficiary (Son) obtaining that ownership interest. Thus, each year that W lived and did not exercise the power, Son received that amount of value, which, added together at W's death, reduces the amount of W's \$1 million exclusion available to him."

8. Page 4: Disclaimer by Beneficiary

Delete the last sentence in the last paragraph following Example 1; add the following Example 2:

"Example 2: Trustor A dies, leaving three properties to his child B and his two grandchildren C and D. C and D each file a disclaimer to Property 2 and Property 3 (upon discovering that the grandparent/grandchild exclusion will not apply), and under the trust terms, Property 2 and Property 3 transfer directly to B. Thus, B is treated as the owner of Property 2 and Property 3 as of the date of A's death, and the parent/child exclusion would apply, again assuming all requirements were met. The step transaction doctrine does not apply unless the transfer from B was "restricted" under the terms of A's trust, that is, A could only transfer any trust property he owned to his two children. (Annotation No. 625.0090, Eisenlauer Letter 5/23/89 and LTA No. 98/23.)"

9. Page 5: Partnerships

No changes; however, see discussion on Partnerships in attached 10/29/99 letter on Level II Change in Ownership Coursebook to Sonoma County Assessor.

10. Pages 5-6: Stock Cooperative/Cooperative Housing Corporations

No changes. However, you may wish to mention the following: 1) that the new base year value established on a change in ownership is the fair market value, not the value of the stock; and 2) the exclusion available in Section 62(i) for transfers of stock in a housing coop applies only to low income households under the criteria stated in that section.

11. Pages 6-7: Massachusetts Trust/Business Trust

Move under Partnerships and add the following statement from Rule 462.160(e) at the end of the first paragraph under the heading and before the quotation on page 6:

"A new amendment to Rule 462.160 subdivision (e) states the definition of such trusts, and declares that they are not included under the Trust rule, but are taxable as legal entities and are treated under Rule 462.180 on "Legal Entities."

12. Page 7: Transfers Involving Non-Profit Corporations

Add the following new information after the conclusion of Example 1:

"A new type of charitable organization called a "supporting organization" ("SO") is now popular and advantageous tax-wise among individuals with a high net worth. Individuals who wish to contribute property to a SO must structure it as either a trust (business trust) or a corporation whose purpose is to further the charitable goals of one or more public charities it chooses to support. To obtain SO classification and the tax benefits of being a charity itself, the IRS requires that it must be "charitable" under IRC 509 (c)(3) and that its bylaws satisfy certain requirements under IRC 509 (a)(3) regarding its relationship to the charities it supports. There is no requirement however, that property contributed to it must be used exclusively for charitable purposes. Therefore, property transferred to a SO in most cases would not qualify for property tax exemption. Moreover, property transferred from an individual or entity to a SO would

not be excludable from change in ownership under Section 62 (a)(2) because the transferor/contributor cannot sit on the board of trustees or board of directors.³ (For further information see attached article on Supporting Organizations from California Trusts and Estates Quarterly, Vol. 5, N. 3, Fall 1999, pp. 29-33.)"

Page 8 - 9: Partnership Capital vs. Profit/Loss Accounts

No changes on Page 8. We further defined and supported the information in the Eisenlauer opinion (3/12/92) in the Cazadd letter 6/19/98, pages 6-7, attached.

Page 9, last paragraph, beginning with the example in the second sentence, should be corrected as follows:

"For example, Partnership X owns Property 1 and Property 2. The partnership agreement specifies that Property 1 was contributed by A and A received in exchange "class A" partnership shares, comprising 50% of the total capital and profits interests. The agreement states that Property 2 was contributed by B and C who received in exchange "class BC" partnership shares, comprising 50% of the total capital and profits interests. There is no managing general partner who holds any partnership interests. Under this structure, if Partnership X subsequently transfers Property 1 to A and Property 2 to B and C, the transfer would be proportional under Section 62(a)(2). See Annotation No. 220.0245, Cazadd letter 8/17/99, Eisenlauer Letter 3/12/92, and Annotation No. 220.0489, LTA No. 91/03, attached.)"

Page 9: Continuing Partnerships (Page 11 on Fax submitted on 10/29/99)

Suggest the following revisions in the last two sentences of the second paragraph:

"When a partner dies, his/her partnership interest immediately transfers to his heir(s) ... The interests in the partnership are vested in the heir of the deceased partner upon dissolution, but do not become possessory until actual liquidation and distribution..."

Suggest the following addition at the end of Example 1:

"If upon liquidation, Acme Co. deeds an undivided 50% of the partnership property to W and B as tenants-in-common, the transfer is excluded from change in ownership under Section 62(a)(2)."

The views expressed in this letter are of course advisory only. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Sincerely,

Kristine Cazadd
Senior Tax Counsel

³ All persons who are "substantial contributors" to the SO (have given more than 2% or \$5,000 since its inception) are disqualified from serving on the board of trustees or board of directors.

KEC:lg

property/precedent/trustle/99/10kec.doc

Attachments: Annotation No. 220.0810 (Cazadd Letter 10/30/96
& 10/14/99, Eisenlauer Letter 1/10/96),
Annotation No. 220.0771 (Ochner Letter 12/26/90),
Annotation No. 625.0230 (Eisenlauer Letter 4/6/92),
Annotation No 625.0090 (Eisenlauer Letter 5/23/89),

cc: Mr. Dick Johnson - MIC:63
Mr. David Gau – MIC:64
Mr. Charlie Knudsen – MIC:64
Ms. Jennifer Willis - MIC:70